

GAO

Report to the Chairman, Committee on
Government Reform, House of
Representatives

May 2002

DOD CONTRACT MANAGEMENT

Overpayments Continue and Management and Accounting Issues Remain



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Abbreviations

CCR	Central Contract Registry
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFAS	Defense Finance and Accounting Service
DMO	Debt Management Office
DOD	Department of Defense
DPPS	Defense Procurement Payment System
FAR	Federal Acquisition Regulation
FDPS	Federal Procurement Data System
IG	inspector general
MOCAS	Mechanization of Contract Administration Services
SFFAS	Statement of Federal Financial Accounting Standards
SPS	Standard Procurement System



United States General Accounting Office
Washington, D.C. 20548

May 30, 2002

The Honorable Dan Burton
Chairman
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

Since we reported on Department of Defense (DOD) contractor overpayments in 1994,¹ we have issued additional reports highlighting billions of dollars of overpayments to Defense contractors. As a result of these and other reports, there has been increasing congressional interest in recovering overpayments made to contractors. In December 2001, this interest led to the Congress amending Title 31 of the United States Code² to require a federal agency with contracts totaling over \$500 million in a fiscal year to have a cost-effective program for identifying payment errors and for recovering amounts erroneously paid to contractors.

You requested that we update our previous reviews to determine whether DOD's problems with overpayments continue. Specifically, we determined (1) whether overpayments and underpayments to contractors have continued, (2) what actions DOD has taken to address payment discrepancies with contractors, and (3) whether the Defense Finance and Accounting Service (DFAS) properly accounts for and collects amounts due from contractors and accounts for amounts the government owes contractors.

Amounts due the government from DOD contractors can arise from (1) improper payments made because of progress payment liquidation errors, contractor billing errors, and other processing errors and (2) contract administration actions, such as item price adjustments, changes in delivery schedules, and changes in the quantities ordered, all of which can occur after valid payments have been made on a contract. The Federal Acquisition Regulation (FAR) refers to any amounts due the government resulting from these actions as contractor debt or

¹U.S. General Accounting Office, *DOD Procurement: Millions in Overpayments Returned by DOD Contractors*, [GAO/NSIAD-94-106](#) (Washington, D.C.: Mar. 14, 1994).

²31 U.S.C. 3561-3567, National Defense Authorization Act for Fiscal Year 2002, section 831, Public Law No. 107-107, 115 Stat. 1012, 1186 (2001).

overpayments. However, not all of these overpayments could appropriately be considered improper payments. Specifically, those resulting from contract administration actions were correct when made, but due to subsequent changes, the excessive portion of the payment is to be immediately pursued and promptly collected.

To accomplish our objectives, we (1) surveyed 183 DOD contractors, as agreed to with your staff, similar to the approach we took in our 1995 report on contractor payment problems,³ (2) assessed DFAS data on contractor refunds, (3) obtained the status of DOD corrective actions on our previous recommendations, and (4) reviewed the management of and accounting for overpayments and underpayments. We focused our work at DFAS Columbus, which was also the area of emphasis in prior audit reports on DOD contractor payment problems, because it is the largest, centralized DFAS disbursing activity—disbursing \$78 billion of contract payments to DOD contractors in fiscal year 2001. To effectively use audit resources, the Defense Contract Audit Agency (DCAA), as part of its contract audits at high-risk contractors, tested the validity of selected contractor survey responses for us.

Our scope and methodology are described in more detail in appendix I. We did not fully assess the reliability of the underlying data in the contractors' responses or the data we obtained from DFAS Columbus. We reviewed and discussed DCAA's work at selected contractor locations where it performed follow-up work for us. We requested comments on a draft of this report from the Secretary of Defense or his designee. We received written comments from the Under Secretary of Defense Comptroller and have reprinted the comments in this report. We performed our work from August 2001 through April 2002 in accordance with generally accepted government auditing standards.

Results in Brief

DOD contractors' responses to our survey indicate that they have millions of dollars in overpayments and underpayments on their records, and based on DFAS Columbus records, they are continuing to refund overpayments—about \$488 million in fiscal year 2001. Contractors cited progress payment liquidation errors as a primary reason for the overpayments and underpayments. They usually did not include debt due to contract

³U.S. General Accounting Office, *DOD Procurement: Millions in Contract Payment Errors Not Detected and Resolved Promptly*, GAO/NSIAD-96-8 (Washington, D.C.: Oct. 6, 1995).

administration actions—the reason for the majority of contractor refunds according to DFAS Columbus records—in their reported overpayments. Additional overpayments and underpayments could be identified when audits of the over 3,200 contracts requiring some level of reconciliation, as of September 30, 2001, are completed by DFAS Columbus. Contractor debt, regardless of cause, is likely to continue due to DOD’s complex contract management and payments processes. Even when payment discrepancies are identified, they are not always promptly resolved.

DOD has taken actions to address problems with contractor overpayments. In addition to its contract audit functions and as part of a broad-based program to assist DCMA and DFAS, DCAA is auditing at least 190 large DOD contractors to identify overpayments and ensure that contractors have adequate internal controls for prompt identification and reporting of overpayments. This type of activity can be considered part of a recovery audit program. DFAS Columbus has implemented procedures to better identify potential duplicate payments before the invoices are paid and to determine and monitor the causes of the duplicate payments. As part of its long-term solution to contract payment problems, DOD also is implementing the Standard Procurement System and the Defense Procurement Payment System to replace current contract administration and payment systems. However, the full implementation of these systems has been delayed and their success is uncertain.

While DOD has several initiatives to reduce overpayments, it still does not yet have basic accounting control over contractor debt and underpayments because its procedures and practices do not fully meet federal accounting standards and federal financial system requirements for the recording of accounts receivable and liabilities. As a result, DOD managers do not have important information for effective financial management, such as ensuring that contractor debt is promptly collected. Further, DOD’s reported accounts receivable, accounts payable, and other liabilities could be understated or overstated at the end of an accounting period. Without complete accounting for overpayments and underpayments, DOD has not established adequate performance measures to monitor and manage the timely resolution of overpayments and underpayments.

This report contains recommendations to the Under Secretary of Defense Comptroller and the Under Secretary of Defense for Acquisition, Technology, and Logistics concerning actions to require internal controls on the recovery of overpayments, establish procedures for the recording of receivables and liabilities, and to develop and maintain more complete

records on contractor refunds and underpayments. In written comments on a draft of this report, DOD concurred with our report recommendations and discussed actions it intends to take to implement each of our recommendations. These actions appear to respond to our recommendations.

Background

DOD's contract administration and payment processes involve numerous organizations, including 23 DFAS offices; the contractors that perform work and bill the government; the Defense Contract Management Agency (DCMA), which administers most of DOD's largest procurement contracts; military components' project and contracting offices; and DCAA, which reviews contractors' records, internal controls, and billing systems. The contract administration and payment processes have been described in our prior reports. If DCMA administers a contract, DFAS Columbus makes payments using the Mechanization of Contract Administration Services (MOCAS) system, and DOD refers to the disbursements as "contract pay." In fiscal year 2001, DFAS Columbus disbursed about \$78 billion for over 300,000 contracts managed in MOCAS. Contracts that DCMA does not administer are paid using other systems at the DFAS offices. DOD refers to these contract disbursements as "vendor pay." The Navy's shipbuilding and repair contracts are viewed as vendor pay because they are not managed by DCMA or paid by DFAS Columbus using MOCAS. In fiscal year 2001, DFAS processed over 10 million vendor pay invoices, valued at over \$59 billion. Large contractors with numerous DOD contracts and locations can receive both contract pay and vendor pay. Effective April 1, 2001, DFAS contract pay and vendor pay management were consolidated at DFAS Columbus.

Contract payments involve payments for the delivery of goods and services and financing payments. Financing payments include (1) progress payments to cover a contractor's costs as they are incurred during the construction of facilities or the production of major weapons systems and (2) performance-based payments that are based on the accomplishment of particular events or milestones—typically used on production contracts. When contractors deliver items and submit invoices for the delivered items, DFAS Columbus deducts financing payments from the prices of the delivered items, or "liquidates" the financing payments, based on a predetermined liquidation rate. Liquidation rates may be adjusted when costs are higher or lower than projected. Contract modifications can often occur due to changes in liquidation rates, quantities ordered, and production schedules. These modifications and other contract

administration actions are managed by DCMA through coordination with the contractors.

Our prior reports on contractor overpayment problems have highlighted that (1) Defense contractors were refunding hundreds of millions of dollars to DFAS Columbus each year, (2) DFAS Columbus had made overpayments due to duplicate invoices and paid invoices without properly and accurately recovering progress payments, (3) contract administration actions had resulted in significant contractor debt or overpayments, (4) DOD and contractors were not aggressively pursuing the timely resolution of overpayments or underpayments when they were identified, (5) DFAS Columbus did not have statistical information on the results of contract reconciliation, and (6) DOD has ongoing actions to address contractor payment problems.

DFAS Columbus can identify overpayments during contract reconciliation or can be notified of an overpayment by a contractor or DCMA. When DFAS Columbus becomes aware of an overpayment, its Accounts Receivable Branch is to issue an initial demand letter to the contractor and works with the entitlement divisions, which process and pay invoices, to collect amounts due the government by initiating an “offset” that reduces the amount paid on invoices in process. The Accounts Receivable Branch also maintains the detailed records on the accounts receivable. The contract reconciliation function deals with contracts being closed out as well as active contracts needing partial audits to resolve prior and current payment problems, such as overpayments, underpayments, and invoice deficiencies. Since the mid-1990s, DFAS Columbus has contracted with a major accounting firm to help reconcile and close out thousands of contracts. When an amount exceeding \$600 is due to the government and is not collected within 90 days, the debt is supposed to be transferred to DFAS’s central Debt Management Office (DMO) for further collection actions that can include referring debts to the Defense Criminal Investigative Service or the U.S. Treasury’s centralized debt collection programs.

Within the last 6 months, three key actions have been taken to address governmentwide issues on improper payments. As previously stated, in December 2001, the Congress amended Title 31 of the United States Code to require an agency with contracts totaling over \$500 million to have a cost-effective program for identifying payment errors and for recovering amounts erroneously paid to contractors. The resources for implementing the recovery program can include the agency, other federal departments or agencies, and the private sector. As of March 2002, the Office of Management and Budget had not issued implementing guidance on this law.⁴ Another key action was our issuance of an executive guide,⁵ in October 2001, that discusses strategies and control activities, such as recovery auditing, contract audits, and data mining, to identify and correct improper payments. The third action, in response to our recommendation,⁶ was a change in the FAR, effective February 19, 2002, which added a paragraph to the “prompt payment” clause of contracts that requires a contractor to notify the contracting officer if the contractor becomes aware of an overpayment and to request instructions for disposition of the overpayment.

Overpayments and Underpayments Continue

Defense contractors’ responses to our survey indicated that they have millions of dollars in overpayments and underpayments on their records, and based on DFAS Columbus records, they are continuing to refund overpayments. According to the contractors, a primary reason for these payment discrepancies was progress payment liquidation errors. Contractors usually did not include contractor debt arising from contract administration actions in the overpayments amounts they reported. However, according to DFAS Columbus records, contract administration actions were the primary reason for the \$488 million that contractors refunded in fiscal year 2001. Contractor refunds are likely to continue because of DOD’s complex contract management and payment processes. Also, even when payment discrepancies are identified, they are not always promptly resolved.

⁴31 U.S.C. 3561-3567.

⁵U.S. General Accounting Office, *Strategies to Manage Improper Payments: Learning From Public and Private Sector Organizations*, [GAO-02-69G](#) (Washington, D.C.: Oct. 2001).

⁶U.S. General Accounting Office, *DOD Contract Management: Greater Attention Needed to Identify and Recover Overpayments*, [GAO/NSIAD-99-131](#) (Washington, D.C.: July 19, 1999).

Contractors Reported Overpayments and Underpayments but Extent of Them Is Uncertain

Based on information from our surveys, business units of 67 contractors reported that they had about \$62 million of overpayments and about \$176 million of underpayments in their records as of September or October 2001.⁷ We sent surveys to 497 business units of 183 contractors, and at least 249 of the business units of 120 contractors responded. The business units of the remaining 53 contractors that responded did not report any overpayments or underpayments in their records. Appendix II provides the details of our survey results and appendix III contains the survey.

As shown in table 1, which summarizes the results of the survey, 34 of the largest contractors did not respond to the survey. The 10 largest contractors—according to their reported annual billings—that responded to our survey reported about 86 percent of the total overpayments and 78 percent of the total underpayments reported by all of the contractors. One Boeing contract alone accounted for \$27 million of underpayments due to contract funding issues. Contractors cited DFAS progress payment liquidation errors as a primary reason for the overpayments and underpayments. Contractors usually did not include contractor debt arising from contract administration actions in the overpayment amounts they reported. However, as discussed later in this report, contract administration actions are the primary source of contractor refunds. Most of the contractors reported that demand letters had not been issued for the overpayments in their records but that they planned to return about 29 percent of the overpayments by check or offset. For the remaining 71 percent of the overpayments, contractors did not indicate any planned actions. According to DCAA, it plans to ensure that all of the overpayments are properly handled.

⁷Even though we requested data as of September 30, 2001, some contractors reported as of that date and others reported as of various dates, most in October 2001.

Table 1: Summary of Survey Results by Large and Small Business Contractors

	Large contractors surveyed ^a	Small business contractors surveyed ^a	Total
Number of contractors surveyed	92	91	183
Number of contractors with at least one response	58	62	120
Number of contractors that did not respond	34	29	63
Number of contractors reporting overpayments	31	11	42
Number of contractors reporting underpayments	31	26	57
Number of contractors reporting zero payment discrepancies	21	32	53
Total overpayments reported (dollars in millions)	\$61.0	\$1.0	\$62.0
Total underpayments reported (dollars in millions)	\$165.3	\$10.8	\$176.1
Total gross billings reported (dollars in millions)	\$28,656.0	\$2,718.0	\$31,374.0

^aLarge contractors have the highest dollars of contract actions in the Federal Procurement Data System, and small business contractors are designated as such in the system.

Source: GAO survey results.

These survey results cannot be used to determine the extent of overpayments and underpayments in contractor records at a point in time. Specifically, the results cannot be projected to a universe of DOD contractors even if all contractors had reported because the surveyed contractors were not randomly selected. Further, our analysis of contractors' responses showed inaccuracies in their reporting. For example, at least 3 contractors included information on contract payments to federal agencies other than DOD and even to nonfederal entities. At least 1 contractor reported overpayments that had been refunded the government and, therefore, should not have been reported because they were not outstanding overpayments. We also observed that contractors were not consistent in reporting actions taken on overpayments. Out of at least 588 reported overpayments, contractors indicated in their responses that they had notified DOD of 251 overpayments. At the same time, contractors reported that they had not notified DOD of 236 overpayments. For the remaining 101 overpayments, contractors did not provide any indication one way or the other.

Based on factors such as contractor size, geographic location, and amount of reported payment discrepancies, we selected, in coordination with DCAA, 27 contractor locations involving 24 companies to test the validity of contractors' responses. The selected business units reported \$58 million, or 94 percent, of the total reported overpayments and \$126 million, or 71 percent, of the total reported underpayments. We provided our survey results to DCAA for these business units, and its auditors found that 10 of the contractor locations underreported overpayments by \$57.2 million and underreported underpayments by \$58.0 million. DCAA stated that the remaining 17 locations had reported accurately. According to DCAA, 5 contractors are primarily responsible for these large differences and most of the differences are due to contractors' billing weaknesses and erroneous reporting of unpaid invoices. Appendix IV summarizes the DCAA results. At these same 10 contractor locations, DCAA also found that (1) differences in application of liquidation rates and weaknesses in contractor billing systems were primary reasons for both overpayments and underpayments and (2) unpaid invoices over 30 days old were another primary reason for underpayments. Such results demonstrate the need for recovery audit programs, such as DCAA's contractor overpayment and underpayment audits to identify payment errors, recover erroneous payments, and identify payments due to the contractor.

During its follow-up to our surveys, DCAA also found that contractors are reluctant to return overpayments on a contract when underpayments on the same contract result in a net underpaid status. For example, 1 of the largest DOD contractor's records showed a contract with millions of dollars of overpayments and underpayments that resulted in a \$1.8 million net underpaid status. According to the contractor's records, some of these overpayments had occurred in 1997 and had not been resolved. As of September 30, 2001, the contract was in reconciliation, and, as of February 2002, these payment discrepancies had not been resolved. According to DCAA officials, they decided, after consulting with DFAS, that settlement of any overpayments and underpayments would be deferred until contract reconciliation is complete and the final contract amount is settled. DCAA officials stated that the contractor had basic internal controls for overpayments, and DCAA is assisting the reconciliation through its project on audits of contractor-prepared reconciliations.

In responses to our survey, contractors also included overpayments and underpayments associated with contracts paid through vendor pay. For example, at least 28 contractors, including 3 major shipbuilding and ship

repair contractors, reported overpayments and underpayments associated with vendor pay. These 3 major shipbuilding contractors, alone, reported overpayments of almost \$9.4 million and underpayments of about \$0.5 million. According to a response from 1 shipbuilding contractor, overpayments and underpayments that occur on a contract are not resolved until contract closeout, which could be several years later. Another vendor pay contractor reported about \$12 million of underpayments primarily due to underpaid invoices. For contractors indicating receipt of vendor pay, we could not accurately eliminate the vendor pay discrepancies from the total amounts reported by the contractors because (1) not all contractors provided sufficient and consistent detailed information and (2) we did not validate all of the responses. Nevertheless, we asked DFAS Columbus to compare its records to the contractor responses for 106 contracts, and DFAS Columbus told us it did not make the payments on 42 of the contracts because they were vendor payments.

Although our prior reports placed more emphasis on contract pay than vendor pay, recent DOD Office of Inspector General (IG) audits also have identified weak internal controls in vendor pay systems and overpayments to contractors. For example, in October 2001 and March 2002, the DOD IG reported that the Computerized Accounts Payable System, a vendor pay system used by DFAS Kansas City and DFAS Indianapolis, did not have proper internal controls to detect and prevent improper payments, and that DFAS had made at least \$13 million of duplicate payments.⁸ As a result, recovery audits and recovery activities that are now required by 31 U.S.C. 3561 could be used to improve the management of contract payments associated with both “contract pay” and “vendor pay.”

**Contractor Refunds
Primarily due to Contract
Administration Actions but
Improper Payments Also
Occurred**

From fiscal years 1994 through 2001, DOD contractors have refunded over \$6.7 billion to DFAS Columbus. However, as shown in table 2, DFAS Columbus records showed that contractor refunds dropped to about \$488 million in fiscal year 2001 from \$901 million in fiscal year 2000. Of the \$488 million in refunds, DFAS Columbus collected \$449 million by

⁸DOD Inspector General, *Controls Over the Computerized Accounts Payable System at Defense Finance and Accounting Service Kansas City*, Report No. D-2002-008 (Washington, D.C.: Oct. 19, 2001), and *Financial Management: Controls Over Vendor Payments Made for the Army and Defense Agencies Using the Computerized Accounts Payable System*, Report No. D-2002-056 (Washington, D.C.: Mar. 6, 2002).

contractors submitting checks and the remaining \$39 million through offsets. However, the level of refunds could be greater because contracting officers often collect funds from the contractors by offsets that are agreed to during contract negotiations, and DFAS might not be notified. Since DFAS keeps track of only those offsets it processes, its records would not have the number of refunds due to these other offsets handled directly by DCMA and the contractors.

Table 2: Refunds to the Government from Fiscal Years 1994 through 2001

Dollars in millions	
Fiscal year	Amount of refunds
1994	\$940
1995	1,000
1996	1,020
1997	950
1998	746
1999	670
2000	901
2001	488
Total	\$6,715

Source: GAO reports and DFAS Columbus.

DFAS Columbus records showed that about \$360 million, or 80 percent of the \$449 million in checks sent to the government in fiscal year 2001, was due to DCMA contract administration actions and the remaining \$89 million, or 20 percent, was due to payment problems. This is consistent with what we have previously reported. For example, in February 2001,⁹ we reported that 77 percent of \$351 million in excess payments was primarily related to contract administration actions, and, in July 1999, we reported¹⁰ that about 78 percent of the contractor refunds was due to contract administration and other actions outside of DFAS's control.

⁹U.S. General Accounting Office, *Contract Management: Excess Payments and Underpayments Continue to Be a Problem at DOD*, GAO-01-309 (Washington, D.C.: Feb. 22, 2001).

¹⁰GAO/NSIAD-99-131.

In tracking contractor refunds due to payment problems, DFAS Columbus distinguishes between refunds with issued demand letters and refunds without demand letters—or unsolicited refunds. According to DFAS Columbus records, refunds due to payment problems were caused primarily by DFAS processing errors, including improper progress payment liquidations. We reviewed 12 unsolicited contractor refunds valued at about \$24.2 million, or 83 percent of the total \$29.2 million in unsolicited contractor refunds during the months of October 2000, March 2001, and August 2001. Our review revealed that 6 of the overpayments were due to progress payment liquidation errors and 6 were duplicate payments caused by contractor billing errors along with DFAS weaknesses in detecting and avoiding overpaying in these situations. Some examples follow.

- In September 2000, Textron Systems refunded \$8,194,856 because of a DFAS error in liquidating progress payments. In August 2000, Textron billed a net amount of \$2,739,301, based on contract delivery price of \$10,957,205, of which \$8,217,904 should have been liquidated. However, DFAS paid \$10,934,158 in August 2000.
- In July 2001, Boeing refunded \$5,527,922 due to the incorrect liquidation of progress payments on two invoices. DFAS overpaid one invoice by \$2,077,922 and another invoice by \$3,450,000 because it used an incorrect liquidation rate.
- In March 2001, Northrup Grumman refunded \$1,855,788 for a duplicate payment. DFAS first paid this amount in September 1999 for an invoice submitted in August 1999, and it paid the same amount again in January 2000. DFAS documentation did not indicate what allowed the invoice to be processed twice. The unsolicited refund was about 15 months after the overpayment.
- In August 2001, the Eagle Support Services Corporation refunded \$958,339 because it had received two payments for the same invoice. The contractor submitted an electronic invoice on June 28, 2001, which DFAS paid on July 10, 2001. However, the contractor had earlier submitted a hard copy invoice on June 11, 2001, which DFAS paid on July 18, 2001. DFAS processed each invoice because the invoices had different shipment numbers.

DOD contract management, payment, and accounting processes are complex and remain at risk of contractor debt arising from contract administration actions and overpayments caused by payment and billing errors. We reported in January 1998¹¹ that DOD's contract management and payment process involves numerous organizations that share data using both manual and automated means that are not integrated. Since then, DOD has implemented more electronic sharing of contract information and invoicing to reduce manual processes. However, in December 2000 and April 2001, the DOD IG reported that additional controls were needed in electronic document sharing and interchange to ensure security of the data.¹² In addition, DFAS personnel told us that contract and invoicing information still must be manually entered into MOCAS. For example, contracts with special payment instructions need to be processed manually because they are an exception to the MOCAS automatic payment process.

One effect of the overall complex process is that DFAS Columbus can sometimes issue demand letters that it later cancels due to subsequent contractor, contracting officer, or DFAS actions to correct or otherwise resolve the basis for the debt. In fiscal year 2001, DFAS Columbus canceled \$37.5 million of demand letters. A few examples follow.

- Lucent Technologies almost received a duplicate payment of \$1,397,200 when the contractor submitted invoices to DFAS Omaha in October 2000 and DFAS Columbus in December 2000 for the same amount. DFAS Omaha, the originally designated contract payment office, paid the first invoice. Subsequently, DFAS Columbus became the payment office, and the contractor resubmitted the invoice to DFAS Columbus, which initiated payment. However, DFAS Columbus identified the duplicate payment, issued a demand letter, and then canceled the demand letter when it stopped the electronic funds transfer payment before it was processed by the contractor's bank.

¹¹U.S. General Accounting Office, *Financial Management: Seven DOD Initiatives That Affect the Contract Payment Process*, GAO/AIMD-98-40 (Washington, D.C.: Jan. 30, 1998).

¹²DOD Inspector General, *Controls Over Electronic Document Management*, Report No. D-2001-101 (Washington, D.C.: Apr. 16, 2001); *Controls for the Electronic Interchange at the Defense Finance and Accounting Service Columbus*, Report No. D-2001-095 (Washington, D.C.: Apr. 6, 2001); and *General Controls Over the Electronic Document Access System*, Report No. D-2001-029 (Washington, D.C.: Dec. 27, 2000)

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- In April 2001, DFAS issued a demand to Lockheed Martin for a \$2,755,244 debt that occurred in September 1997 when a contracting officer issued a contract modification reducing the contract amount. An April 1998 audit of the contract identified that the wrong accounting line was cited in this modification, which created a debt. Even though the contracting officer was notified of the mistake at that time, no action was taken until DFAS issued the demand letter. In May 2001, a contracting officer prepared another contract modification to cite the correct accounting line, which eliminated the debt. DFAS then canceled the demand.
 - A demand to Litton Systems Advanced, Inc. for a \$2,124,022 overpayment was canceled when the contractor sent an invoice with the amount reduced for the overpayment.

The entire contract management and payment process, which has been described in our prior reports, is further complicated by how progress payments are accounted for in contract records, a method that can ultimately create (1) differences in contractor and DFAS Columbus records and (2) future payment and contract reconciliation problems. In April 1997, we reported¹³ that contract payment problems can occur when DFAS Columbus liquidates progress payments because of payment allocations to an accounting classification reference number on a contract that have little relationship to the work performed. If payment allocations must be made using a different process than the MOCAS automated process, especially when contracts have special payment instructions, the risk of error increases. As mentioned earlier in this report, contractors responded that progress pay liquidation errors were a major reason for overpayments. This is consistent with our October 1995 report¹⁴ indicating that according to DFAS Columbus analysis the most frequent cause of an overpayment was the incorrect recovery of progress payments. DFAS Columbus data on fiscal year 2001 overpayments showed that progress payment liquidation problems were one cause of the overpayments, but that the primary reasons were contract modification and invoice processing errors.

¹³U.S. General Accounting Office, *Contract Management: Fixing DOD's Payment Problems Is Imperative*, [GAO/NSIAD-97-37](#) (Washington, D.C.: Apr. 10, 1997).

¹⁴[GAO/NSIAD-96-8](#).

Overpayments Likely to Be Identified by Contract Reconciliation

Even though contractors or contracting officers identify many overpayments, the DFAS Columbus contract reconciliation function is also likely to identify many overpayments. Of the 2,512 demand letters issued by DFAS Columbus in fiscal year 2001, its records showed that contract reconciliation had identified overpayments associated with 1,115 demand letters, valued at about \$83.4 million. Its records also showed that the contractor or a contracting officer had initiated the remaining 1,397 demand letters, valued at about \$43.8 million. The contract reconciliation process is intended to identify and correct imbalances between (1) the contractor's invoiced amounts and recorded amounts paid in MOCAS, (2) contract obligation and disbursement balances in DFAS accounting records and MOCAS, and (3) the contract obligation amount and MOCAS obligation and disbursement amounts. The contract reconciliation function at DFAS Columbus deals not only with contracts that are candidates for closure but also those contracts needing partial audits to resolve prior payment problems and correct deficiencies so that DFAS Columbus can pay current invoices.

As shown in table 3, at fiscal year-end, the number of contracts waiting for reconciliation had averaged about 2,300 for the past 7 years. However, during the year, the number of contracts going through reconciliation can be much greater. For example, in fiscal year 2001, DFAS Columbus processed over 8,100 contracts through reconciliation. As of September 30, 2001, DFAS Columbus had 3,249 contracts waiting for some level of reconciliation, a higher level than in the prior 6 years. Based on prior year results, contract reconciliation will likely identify millions of dollar of overpayments needing resolution.

Table 3: DFAS Columbus Contracts Waiting for Reconciliation at Fiscal Year-End from 1995 to 2001

Fiscal year-end	Number of contracts awaiting reconciliation
1995	2,372
1996	2,553
1997	2,167
1998	2,494
1999	1,881
2000	1,507
2001	3,249
Average for fiscal years	2,318

Source: DFAS Columbus.

As shown in table 4, of the 3,249 contracts awaiting reconciliation, as of September 30, 2001, 575 had been in this status for over 360 days, while 1,523 of the contracts had been awaiting reconciliation for 90 days or less. This is fewer than what we reported¹⁵ in July 1999 when over 900 of 2,453 contracts had been in reconciliation for over a year. Included in the contracts awaiting reconciliation are contracts for some of the largest contractors included in our survey. For example, 3 of the largest DOD contractors that responded to our survey—Lockheed Martin, Raytheon, and Boeing—had 205, 191, and 119 contracts, respectively, waiting for reconciliation as of August 31, 2001. In addition, 1 of the large contractors that did not respond to our survey had 56 contracts in reconciliation at DFAS Columbus. As noted later in this report, DCAA is auditing contractor-prepared reconciliations at these large contractors, and DFAS uses the audit results in completing the contract closeout process.

¹⁵[GAO/NSIAD-99-131](#).

Table 4: Aging of DFAS Columbus Contracts Awaiting Reconciliation as of September 30, 2001

Days in reconciliation	Number of contracts awaiting reconciliation
90 days or less	1,523
91 to 180	666
181 to 360	485
361 to 720	219
Over 720	356
Total	3,249

Source: DFAS Columbus.

The error-prone nature of the contract management and payment process is illustrated by over 15,000 contracts in fiscal years 2000 and 2001 combined that have gone through some level of reconciliation at DFAS Columbus. Contract provisions often change, affecting deliveries, progress payment liquidation rates, and indirect cost rates, which creates excess payments after invoices have been paid. As we reported¹⁶ in January 1998, MOCAS records may differ from the accounting office records because contract information, such as modifications, may not have been properly and consistently processed by all locations. DFAS and contractors can process invoices in different sequences resulting in discrepancies in how progress payments are liquidated. As a result, many contracts can require some type of reconciliation more than once during their life. DFAS Columbus contract reconciliation results for fiscal year 2001 indicated that the majority of payment problems identified during research were due to payment system errors and erroneous processing of contract modifications.

Overpayments Are Not Always Recovered Promptly

We also have previously reported that overpayments are not always recovered promptly.¹⁷ As mentioned in prior reports, such delays can cost the government in lost interest charges and use of the funds.

¹⁶GAO/AIMD-98-40.

¹⁷GAO-01-309 and GAO/NSIAD-99-131.

According to DFAS Columbus records, even though it had collected almost \$85.7 million in fiscal year 2001, problems remain with the timely recovery of overpayments. For example, of the 546 overpayments, including voluntary contractor refunds, for which DFAS Columbus had recorded in its records both the check receipt date and the date the overpayment was identified, only 75 were refunded within 30 days, with 294 being refunded after 90 days. Moreover, 360 additional refunds did not have the dates necessary to determine the timeliness. Further, as of August 2001, DFAS Columbus accounts receivable records showed that about \$26 million out of \$54.8 million total receivables, or 47 percent, had been outstanding for over 90 days. Of those outstanding for over 90 days, about \$18.8 million had not been resolved for over a year because contractors had disputed these receivables—also discussed later in this report. We reviewed 11 files for these old accounts receivable and some examples follow.

- In November 1997, DFAS Columbus issued a demand letter to McDonnell Douglas for \$2,294,454. The contractor disputed the demand and, in March 1998, the contract was submitted to audit. As a result of the audit, the demand was reduced to \$27,904. However, DFAS did not issue a demand for the reduced amount. In May 2000, DFAS decided to update the audit on the contract. As of December 2001, over a year after the second audit, the recorded receivable was still \$2,294,454 because the DFAS Columbus Accounts Receivable Branch had not been informed of the audit results.
- In August 1996, DFAS Columbus issued a demand letter to Hughes Aircraft for \$2,032,113. DFAS subsequently issued a second demand letter in September 1996. The contractor disputed the demand but did not provide sufficient detail to support the dispute so that an audit could resolve the dispute. In January 1997, DFAS Columbus asked the contractor for additional information, and the contractor responded that the problem might be with several different progress payment and liquidation rates on the contract. As of December 2001, the account receivable file showed that no action had been taken.
- In September 1999, DFAS Columbus issued a demand letter for \$3,886,567 to Raytheon because of a duplicate payment that had occurred in 1995. The contractor disputed the demand and provided evidence that it had sent a check for \$3,137,200 for the debt in August 1995. However, according to DFAS Columbus, this left a balance due of \$749,369. In November 1999, DFAS issued a demand letter for this new

balance due, and Raytheon disputed the remaining amount of the debt. As of December 2001, the \$749,369 demand had not been resolved.

After we shared our concerns about aged disputes with DCAA, it attempted to resolve these receivables as part of its recovery audit effort. As of this report's date, DCAA is still in the process of examining contractor data to determine the validity of the debt. DFAS inattention to resolving these disputed receivables and determining their validity could result in potentially overstated accounts receivable balances. Further, contract closeout problems, which we reported on in July 2001,¹⁸ can be exacerbated when payment discrepancies are not promptly resolved. We reported that DFAS had made \$615 million of illegal and improper adjustments to closed appropriation accounts, and these adjustments included \$9.9 million of overpayments that had been improperly redistributed to open appropriation accounts after the original accounts were closed.

DOD Initiatives to Manage and Reduce Overpayments

In response to our prior recommendations, DOD has taken both short-term actions and established long-term initiatives to address long-standing contract payment problems that result in overpayments and underpayments. Some of the short-term actions appear to be having some positive results. However, the success of the longer-term initiatives, which are more critical to resolving underlying problems in the contract payment systems and processes, is uncertain.

In the short term, DFAS, DCMA, and DCAA, in coordination with the DOD Comptroller, have initiatives to (1) audit major DOD contractors to identify overpayments and evaluate their internal controls for identifying and reporting overpayments and (2) reconcile and close out old contracts. Specifically, in August 2001, DCAA agreed to assist DFAS in addressing excess payments to contractors, debt collection, invoice payment instructions, contract reconciliation, and professional development. Subsequently, in November 2001, DCAA began audits on overpayments and related contractor internal controls for identifying and promptly reporting overpayments. Its plan is to complete audits at 190 contractors in fiscal year 2002. As of March 2002, the number of contractors to be audited had increased to 195. As part of this effort, DCAA is also examining some of the

¹⁸U.S. General Accounting Office, *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-697 (Washington, D.C.: July 26, 2001).

aged (over 90 days old) accounts receivable in dispute according to DFAS Columbus records.

As of January 2002, DCAA had completed audits of overpayments at 46 contractors and identified over \$22.7 million of overpayments. From additional special audits of progress payments, DCAA identified about another \$27.3 million of overpayments, most of which were promptly resolved. These results illustrate what can be accomplished from programs to identify payment errors and recover erroneous payments. DCAA officials stated that they would continue overpayment audits until contractors' controls ensure prompt identification and reporting of overpayments to DOD. While DCAA efforts could be viewed as a type of recovery activity, DOD does not have an overall recovery audit program that includes all types of contract payments. DCAA also has been involved with the contract reconciliation of old contracts at large contractors to facilitate contract closeout and the transition to the new systems intended to replace MOCAS.

DCMA, in response to DOD overpayment issues, has issued additional guidance to its contracting officers. For example, in April 2000 and November 2001, it issued memorandums on the identification and recovery of overpayments and excess progress payments, respectively. These memorandums emphasized the need for contracting officers to be alert to situations in which contractor debt is incurred and to immediately issue demand letters. Further, in a response to our February 2001 recommendation, DCMA stated that it is using DFAS Columbus information on refunds to identify and evaluate possible systemic contract administration problem areas.

DFAS Columbus, in response to prior reported deficiencies, has implemented practices to provide better oversight of the reasons for overpayments and the results from contract reconciliation. For example, it established a central-tracking database to categorize reasons for contractor refunds. This database identifies different types of possible DFAS Columbus errors and the types of contract administration actions creating the contractor debt. In addition, DFAS Columbus has been tracking contract reconciliation results to identify reasons for the payment problems identified during reconciliation. Although DFAS Columbus personnel easily provided us summary and detailed information from these databases, the information had not been summarized and incorporated into performance management indicators.

An additional DFAS Columbus effort, initiated in May 2000, is to identify and monitor the potential for duplicate payments. Monthly reports, including one on causes of duplicate payments, are prepared for each of the three entitlement sections at DFAS Columbus and summarized for management review. According to the duplicate payment report for the first quarter of fiscal year 2002, DFAS Columbus had avoided making about \$181.7 million of duplicate payments that had been identified as a result of the new procedures. DFAS Columbus has also issued several operating procedures to improve payment processing.

The success of DOD's implementation of new systems to address the root causes of contract administration and payment problems is uncertain. DOD is planning on full implementation of the Standard Procurement System (SPS) and the Defense Procurement Payment System (DPPS) to improve contract management and payment processes by replacing MOCAS, which has been used since 1968. SPS is intended to be DOD's single, standard system to support contracting functions and interfacing with financial management functions, such as payment processing. However, in July 2001, we reported¹⁹ that (1) full implementation of SPS has been delayed 3-1/2 years, (2) DOD had not justified the continued investment in SPS, (3) SPS modules to manage the large weapons systems procurements had not yet been implemented, and (4) the DOD IG had found that the system lacked critical functionality and users were generally dissatisfied with the system.

DPPS is intended to be DOD's standard contract payment system. However, DPPS implementation at DFAS Columbus has been delayed over 2 years—from August 2001 to October 2003. According to DPPS program officials, the implementation of DPPS is not dependent on the full implementation of SPS. Nevertheless, the DOD IG concluded in its September 2001 report that DPPS would not fully eliminate disbursement and contract accounting problems because DFAS, in order to comply with special payment instructions, will need to continue making manual payments for which there is a greater risk of errors being made.

¹⁹U.S. General Accounting Office, *DOD Systems Modernization: Continued Investment in the Standard Procurement System Has Not Been Justified*, GAO-01-682 (Washington, D.C.: July 31, 2001).

Management and Accounting Control Issues Remain

Despite DOD's initiatives and accomplishments in addressing overpayment problems, DOD does not yet have fundamental control over contractor debt and underpayments because its procedures and practices do not fully meet federal accounting standards, federal financial system requirements, and its own accounting policy. Further, DOD managers do not have the performance measures needed to assess compliance with policies and procedures and the extent of overpayment and underpayment problems at a point in time. Specific examples follow.

- Federal accounting standards, federal financial system requirements, and DOD's accounting policy call for the prompt and accurate recording of accounts receivable upon completion of the event that entitles collection of the amount.²⁰ These standards and requirements specify that an amount be estimated if the exact amount is unknown at the time the claim is established. However, contractor debt arising from contract administration actions usually is not recorded as an accounts receivable when the debt is established in the contract or its modification—the event that entitles DOD to collect an amount from the contractor. Instead, the DFAS Columbus Accounts Receivable Branch records an account receivable after it has been notified of the debt and it or DCMA has issued a demand letter. Contractors often refund amounts from contract administration actions, as well as from payment and billing errors, without DCMA or DFAS Columbus issuing demand letters. Together, these factors would tend to mask the extent of overpayment problems and result in overpayments not being known or promptly addressed.
- Federal financial system requirements and DOD accounting policy also stipulate that accounts receivable are to be aged for monitoring and controlling collection. DOD accounting policy specifies that accounts receivable are to be aged into 10 groups, ranging from 1 to 30 days delinquent to over 3 years delinquent. Even though DFAS Columbus tracks the number of accounts receivable in dispute, its Accounts Receivable Branch, which collects overpayments and maintains the

²⁰Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, Mar. 30, 1993; SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, Dec. 20, 1995; Joint Financial Management Improvement Program, *Federal Financial Management System Requirements: Core Financial System Requirements* (Washington, D.C.: Sept. 1995); and DOD, *Financial Management Regulation*, vol. 4, chap. 3, (Washington, D.C.: Jan. 2001).

detailed accounting records to support collection activities, does not routinely age accounts receivable according to DOD accounting policy to help manage and monitor the timely resolution of the accounts.

- DOD policies require that a receivable be recorded within the same month discovered in order to be recorded timely and that contractor debts be promptly collected. However, DOD does not have adequate performance measures on the timeliness of collection efforts for contractor debt once it has been identified.
- Federal accounting standards also specify that accounts payable and other liabilities will be recorded when the potential for the liability is first recognized. Such liabilities include estimates of work completed for facilities and equipment or requests for progress payments for items constructed or manufactured to contract specifications. DFAS Columbus does not maintain detailed records on underpayment liabilities or accounts payable after the contractors notify it of the underpayments, even though the underpayments could be for millions of dollars and take months to resolve.

As a result, DOD managers do not have appropriate management control of accounts receivable and accounts payable and other liabilities stemming from its contract administration and payment processes. Aside from the high risk that these accounting records could be misstated at the end of an accounting period, failure to instill these disciplines magnifies the level of effort required to later identify and collect these amounts.

Contract Administration Events That Create an Account Receivable Are Not Recorded When They Occur

DFAS Columbus does not usually record an accounts receivable when the debt is first created by a contract administration action. Instead, it only tracks the checks from contractors when they are received and the offsets of contractor invoices after they have been completed. DOD policies and procedures require the contracting officer to issue a demand letter to a contractor when an overpayment is identified and to send a copy of the demand letter to DFAS Columbus where it is recorded as an accounts receivable. When contract administration actions are implemented through contract modifications or other signed agreements, these documents recognize that a repayment will result from the action and the amount owed is identified or can be readily calculated. However, DCMA and DFAS do not always issue demand letters for contractor debt based on contract administration actions because the debt could be resolved promptly and issuing a demand letter would involve additional effort.

While federal accounting standards require that such events be recognized as accounts receivable, DFAS cannot recognize the receivable unless it is promptly notified of contractor debt.

In fiscal year 2001, DFAS Columbus records showed that contractors refunded about \$360 million due to contract administration actions, but the Accounts Receivable Branch only recorded about \$127 million of accounts receivable based on issued demand letters that included duplicate payments and other payment errors. This comparison shows that established procedures are not always followed. Additionally, we reported²¹ in February 2001 that contracting officers do not consistently issue demands for payment when contract changes are negotiated even though the amount usually is known or can be calculated. As a result, significant amounts of contractor debt arising from contract administration actions are not being recorded when they first occur as accounts receivable for financial management control and reporting. A further result, discussed later, is that DOD cannot fully measure the timeliness of contractor debt collection so that problems can be identified and effective solutions implemented prior to final contract reconciliation.

Effective February 19, 2002, the FAR was amended to add a paragraph to the recommended “prompt payment” clauses of contracts requiring the contractor to notify the contracting officer if it becomes aware of a duplicate payment or an overpayment on an invoice. By its terms, however, this requirement does not apply to overpayments due to errors in financing payments or contract administration actions. With few exceptions, the contracting officer should include this clause in contracts. A similar revision to the FAR contract financing clauses would ensure that all contractor debt would be promptly identified, reported, and collected. The Office of Federal Procurement Policy is currently reviewing for approval and publication revisions to the FAR financing clauses that will require contractors to notify the government if they become aware of overpayments arising from financing payments. Adequate implementation of these procedures along with prompt contracting officer action could facilitate the proper and complete recording of accounts receivable by DFAS.

²¹[GAO-01-309](#).

Accounts Receivable Were Not Aged

DFAS Columbus is a primary DFAS activity involved in collecting contractor debt and maintaining the detailed accounting records to support collection activities. However, its Accounts Receivable Branch did not routinely age its accounts receivable records, stemming from DOD's contract management and payment process, as required by DOD's accounting policy. The DFAS "Concept of Operations for Recording and Reporting Receivables Due From the Public" effectively exempts DFAS Columbus from this requirement because all receivables that are not collected in 90 days are supposed to be sent to DMO. DFAS Columbus procedures also specify that any debt in excess of \$600 that has not been resolved after two demand letters be transferred to DMO. However, DFAS Columbus personnel told us that when a contractor disputes the first or second demand letter the debt would not normally be transferred to DMO because the validity of the debt has not been established. Even though DFAS Columbus maintained information on the number of accounts receivable in dispute each month, the disputed amounts were not routinely aged. As we discussed earlier, about 47 percent of the receivables were over 90 days old. As of August 2001, over \$23.5 million of the \$35.1 million of demand letters in dispute had been outstanding for months, even years, and, therefore, had not been transferred to DMO.

As a result of the policy exemption and DFAS Columbus not aging its accounts receivable, DFAS did not have proper control over receivables due from contractors. In fiscal year 2001, DFAS Columbus issued demand letters for about \$127 million. However, as shown in table 5, the amounts in dispute averaged about \$33.8 million, or almost 60 percent of the total monthly receivables, during the year.

Table 5: DFAS Columbus Fiscal Year 2001 Monthly Accounts Receivable and Amounts in Dispute

Month	Accounts receivable balance		Accounts receivable in dispute		Percentage dollar value of accounts receivable in dispute
	Number of transactions	Dollars in millions	Number of transactions	Dollars in millions	
October	613	60.0	109	35.9	60
November	597	62.8	110	36.2	58
December	642	57.1	114	32.5	57
January	579	57.8	115	32.6	56
February	582	51.9	114	32.7	63
March	561	51.9	115	33.8	65
April	554	61.8	113	33.6	54
May	666	50.1	116	34.8	70
June	699	61.5	119	35.7	58
July	731	56.7	116	34.8	61
August	782	54.8	118	35.1	64
September	667	55.0	91	27.6	50
Average per month	639	56.8	113	33.8	60

Source: DFAS Columbus and GAO calculations.

In May 2001 and June 2001, the DOD IG and we reported²² that even when debts were transferred to DMO, collection of the debts was not being effectively and proactively pursued. In its comments to our report, DOD indicated that it took immediate actions to monitor and improve debt collection in DMO. However, we did not assess the status and effectiveness of these actions for this report—we limited our review to those accounts receivable that had not been transferred to DMO as of August 2001.

Lack of Performance Measures on Timeliness of Collection Efforts

DOD also does not have adequate performance measures to monitor how timely contractor debt is collected once it is identified. For example, DCMA does not include the timeliness of contracting officers' actions on

²²U.S. General Accounting Office, *Debt Collection: Defense Finance and Accounting Service Needs to Improve Collection Efforts*, GAO-01-686 (Washington, D.C.: June 29, 2001) and DOD Inspector General, *DOD Contractor Debt Collection Process*, Report No. D-2001-114 (Washington, D.C.: May 7, 2001).

overpayments as a key performance measure, and DCMA officials stated that statistics on demand letters issued by contracting officers are not kept. FAR and DCMA's procedures require the contracting officer to take prompt action on contractor debt. However, the contracting officer might not always take immediate action to collect the overpayment due a large workload or oversight. For example, during its follow-up at 1 major contractor, DCAA found that the contractor had reported to its contracting officer a \$59,346 overpayment in June 1998 and a \$144,504 overpayment in March 2001. The contractor assumed that these amounts would be collected by an offset, but DOD did not take actions to collect these amounts until after our survey. In January 2002, the \$144,504 was collected through offsets and a refund check. In December 2001, the \$59,346 had only been partially collect through offset and \$21,913 was still outstanding at the time of DCAA's review in February 2002. In addition, the DFAS Columbus refund records lack key data, such as dates of contract modifications or credit memorandums, needed to measure the timeliness of collection for most refunds of contractor debt arising from contract administration actions. Our review of the documentation for 15 contract administration refunds, valued at \$62.3 million, found that (1) 5 of them did not have enough information to determine whether the funds were collected timely, (2) 2 were collected within 30 days from the time an amount due the government was identified, and (3) 8 were collected in over 30 days—1 in over 90 days and another in over a year.

Even for the offsets that DFAS Columbus processes, it tracks them separately from the other refunds, does not measure the timeliness of collection, or does not always identify the reason for the overpayment. Our review of 15 offsets from January, February, and June 2001 found that 12 of them took over 30 days to fully collect the debt and reasons for the debt were not always identified. Two examples follow.

- On February 21, 2001, United Technologies agreed to DFAS Columbus taking offsets to collect \$8,607,568 of overpayments. Three offsets were taken to collect the full amount—the initial offset occurred on February 24, 2001, and the third offset occurred on March 23, 2001. The recording of these offsets in the contract accounting records was completed on April 6, 2001, or 44 days later. DFAS Columbus records also did not indicate a reason for the overpayment.
- In November 1999, Viasat, Inc. first contacted DCMA about \$2,605,889 it owed the government due to a change in contract terms. The contractor contacted DCMA again in October 2000 to discuss an offset. DCMA

provided DFAS Columbus a credit voucher on November 13, 2000, and DFAS processed the voucher on December 18, 2000. However, DFAS Columbus did not complete the offset until January 29, 2001—97 days after the contractor expressed interest in an offset. DFAS Columbus records did not indicate a reason for the time involved to complete the offset.

In its contractor overpayment audits, DCAA also is examining contractor records on refunds and offsets. According to DCAA, preliminary results from its contractor audits indicate that (1) not all amounts due the government are promptly returned and (2) contractor controls over offsets are weak because the contractors lack supporting documentation and DFAS is not always notified of offsets that occur. As a result, contractor and DFAS accounting records may not agree for certain contracts, and DOD lacks complete information on the amount of refunds being collected.

Inadequate Monitoring of Underpayments

DOD also is unable to fully measure and monitor underpayments and the timeliness of their resolution. Even though DFAS Columbus maintains data on unpaid contractor invoices, it could not provide us any other information on contractor underpayments. According to DFAS Columbus officials, they do not maintain detailed records on underpayments because contractors usually notify them promptly about underpayments, which is not always the case with overpayments. Yet, the contractors that responded to our survey indicated that they had over \$176 million of underpayments in their records at the end of fiscal year 2001. According to federal accounting standards and financial system requirements, such information on underpayments should be routinely recorded and maintained in accounts payable or other liability records. In February 2001, we reported²³ that for the 39 contractors we reviewed, all of the fiscal year 1999 unresolved underpayments had been unresolved for over 180 days. Without complete detailed accounting records on payables, DFAS Columbus is unable to adequately monitor the resolution of underpayments, and the amount of payables reported by DFAS Columbus could be understated at the end of an accounting period. Further, any problems with unresolved underpayments could hinder prompt resolution of overpayments.

²³[GAO-01-309](#).

Conclusions

Survey results, DCAA audits, and DFAS Columbus data indicated that contractor debts resulting from contract administration actions as well as payment problems exist for all DOD contract payments—contract pay as well as vendor pay. Further, resolution of contractor debt has not always been timely. DOD has taken short-term actions, including increased contract audits focusing on overpayments that are achieving immediate results. However, its longer-term initiatives rely on new automated systems that have not been implemented to address many of the existing problems in DOD’s contract management and payment processes. The success of these systems is uncertain because of the problems in functionality, costs, and significant delays that the DOD IG and we have reported on. Until these contract management and payment processes are improved, DOD’s risk of contractor overpayments, regardless of cause, and underpayments will continue. Accordingly, development and implementation of an internal control to identify and recover contractor debt, which is now required by 31 U.S.C. 3561, will be important.

DOD could have better management control of all types of contractor debt, regardless of cause, and underpayments by establishing procedures calling for (1) accounts receivable and liabilities to be recorded in accounting records according to federal accounting standards and federal financial system requirements and (2) mechanisms to hold staff and management accountable for doing so. The accounting records could then provide more comprehensive performance measures for DOD managers to monitor the timely collection of all amounts due the government and resolution of underpayments. Such measures could, in turn, result in more effective financial management and help reduce contract reconciliation and closeout problems in the future.

Recommendations for Executive Action

We recommend that the Under Secretary of Defense Comptroller in coordination with the under Secretary of Defense for Acquisition, Technology, and Logistics

- implement an internal control, as now required by 31 U.S.C. 3561, to identify and collect overpayments to contractors, regardless of contract payment type;
- reevaluate DCMA, DOD Comptroller, and DFAS established procedures and controls and revise them as needed to ensure prompt recognition and recording of receivables and potential liabilities stemming from

DOD's contract management and payment processes, according to federal accounting standards and financial management system requirements; and

- develop and maintain more comprehensive and complete records on contractor refunds and underpayments to better measure and monitor (1) the timeliness of all collections, including checks and offsets, (2) the resolution of demand letter disputes, (3) the causes of overpayments and underpayments, (4) the resolution of overpayments and underpayments and the need for corrective actions, and (5) compliance with policies and procedures.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report, which are reprinted in appendix V. DOD concurred with the report's recommendations.

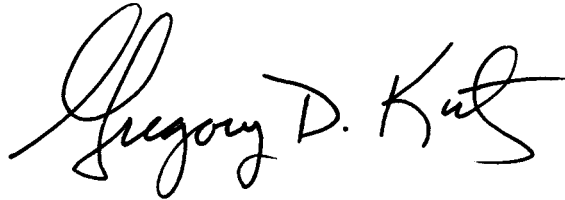
In its comments, DOD emphasized that it supports the requirement for an audit recovery program, was taking actions consistent with such a program before the enactment of 31 U.S.C. 3561, and will comply with future Office of Management and Budget guidance. In addition, DOD stated that (1) DFAS has implemented several additional internal controls in its contractor entitlement and payment process to identify erroneous payments for recovery and minimize future erroneous payments, (2) new MOCAS procedures are being developed and implemented to reduce progress payment liquidation differences, and (3) its contract audit resources are being better used to detect overpayments. DOD also stated that its financial management guidance on recording accounts receivable and payable and account aging is consistent with the federal accounting standards, but to improve compliance requires consideration of the existing processes, factors establishing claims or obligations, and ways to manage efficiently and cost effectively. Further, DOD stated that to improve compliance, (1) DOD is developing new performance indicators on accounts receivable, overpayments, and aging, (2) DFAS is reviewing and revising its procedures in this area, and (3) DFAS Columbus plans to modify its accounts receivable processes to measure the timeliness of collections for amounts due and is working with contractors and DCAA to reduce the number and age of disputes.

DOD also provided detailed technical comments that we incorporated into the report as appropriate.

As you requested, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the issue date. At that time, we will send copies of this report to interested congressional committees. We also will send copies of this report to the Secretary of Defense; the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Under Secretary of Defense Comptroller; the Director of the Defense Finance and Accounting Service; and the Director of the Office of Management and Budget. We will make copies available to others upon request, and the report will also be available on GAO's home page at <http://www.gao.gov>.

If you have any questions regarding this report, please contact me at (202) 512-9505 or David Childress at (202) 512-4639. Key contributors to this report are Jean Lee, Harold Reich, Alan Steiner, and Gary Wiggins.

Sincerely yours,

A handwritten signature in black ink that reads "Gregory D. Kutz". The signature is written in a cursive style with a large, stylized initial "G".

Gregory D. Kutz
Director, Financial Management and Assurance

Scope and Methodology

To determine the number and value of overpayments and underpayments in selected DOD contractors' records at end of fiscal year 2001, we surveyed 183 DOD contractors. Appendix II has a complete list of these contractors. We identified the top 100 DOD contractors and the top 100 small business DOD contractors based on total dollar value of fiscal year 2000 contract actions recorded in the Federal Procurement Data System (FPDS). After identifying the contractors, we used DOD's Central Contract Registry (CCR) to identify contractor business units, their addresses, and points of contact. Contractors must be in CCR to receive payments, and contractors are responsible for maintaining the data in the registry. About 54 percent of the large DOD contractors had multiple business units. For example, Lockheed Martin, Raytheon, and Boeing had 114, 100, and 61 business units, respectively. Accordingly, we contacted officials at many of the contractors for help identifying the appropriate addresses to which the questionnaires should be sent so that the appropriate finance units would receive them. The appropriate finance units for our survey were those that handle the billings and maintain accounts receivables; some business units for which we had addresses do not maintain these records. We did not send surveys to all of the 200 contractors as listed in FPDS because 1 of them was classified, 7 of the small businesses were also included in the top 100 contractors, 3 contractors' names could not be matched to those in CCR, and 5 contractors listed in FPDS had merged with other contractors—for example, Boeing had merged with McDonnell Douglas—or were business units of major contractors already listed.

We subsequently mailed 497 surveys to business units of 183 DOD contractors requesting the total overpayments and underpayments in their records as of September 30, 2001,²⁴ and specific detail on individual overpayments and underpayments equal to or over \$1,000. The survey is similar to the one we used in our 1995 report.²⁵ A copy of our final survey is in appendix III. We either telephoned or sent follow-up reminders to business units. In response to our mailings and follow-up, we received 249 survey responses from business units of 58 large contractors and 62 small business contractors. However, some of the responses we received did not include all of the business units from the contractor, and others indicated that another business unit would have the information. Twenty-two mailings were returned as undeliverable. The 249 business units that

²⁴See footnote 7.

²⁵GAO/NSIAD-96-08.

responded to our survey reported on overpayments and underpayments associated with over 600 contracts. The findings from our survey apply only to the contractor business units that responded and cannot be projected to any others.

We coordinated with DCAA, as part of its ongoing recovery audits, for its auditors to test the validity of the contractors' responses on 27 business units in our survey. These units reported about \$58 million, or 94 percent, of the total reported overpayments, and about \$126 million, or 71 percent, of the total reported underpayments. We and DCAA selected the business units to visit based on a combination of factors, including geographic location, size of the contractor, the amount of reported payment discrepancies, and the nonreporting of payment discrepancies with significant annual billings. We also visited DCAA offices to discuss the agency's audit results in verifying overpayments and underpayments reported for 9 of the 27 contractor locations.

To determine the status of DOD corrective actions, we obtained and reviewed fiscal year 2000 and 2001 data collected by DFAS Columbus on contractor refunds, offsets, and reasons for the refunds. In addition, we obtained data on the number of contracts in reconciliation at the end of fiscal year 2001, the number of contracts that had been partially or completely reconciled in fiscal years 2000 and 2001, and the reasons for payment problems that DFAS Columbus had identified during reconciliation. We did not verify the data provided.

We also obtained and evaluated fiscal year 2001 accounts receivable balances, which represented demand letters issued by DFAS Columbus. To identify some of the conditions and reasons for overpayments, we selected 58 of the highest dollar transactions from the 3 months in fiscal year 2001 with the highest balances for accounts receivable cancellations, transfers, collections made through offsets, and unsolicited refunds. The transactions selected represented about 80 percent of the total dollar value of the group for that month. In addition, we obtained a detailed list of all accounts receivable over 90 days old as of August 2001 and reviewed the highest dollar value transaction in each year from 1996 through 2001. To further assess the timeliness of collections, we analyzed data in DFAS Columbus records on refunds due to payments errors and attempted to determine the collection time for 15 contract administration action refunds in fiscal year 2001.

Further, we obtained information on performance measures, certain DFAS Columbus procedural changes, and the planned implementation of DPPS. We also discussed payment problems and corrective actions with DFAS Columbus and DCMA officials. We reviewed prior GAO and DOD IG reports on contract payment problems, applicable laws and FAR sections, federal accounting standards and financial system requirements, the DOD *Financial Management Regulation*, DCMA policies and procedures contained in its “One Book,” and DFAS Columbus procedures regarding accounts receivable, contractor refunds, and contract reconciliation.

We requested comments on a draft of this report from the Secretary of Defense or his designee. We received comments from the Under Secretary of Defense Comptroller and have reprinted these comments in appendix V. We conducted our review from August 2001 through April 2002 in accordance with U.S. generally accepted government auditing standards.

List of Contractors We Surveyed and Results

Contractor names and fiscal year 2000 contract actions are from the Federal Procurement Data System. Dollars of overpayments and underpayments are from survey responses received before February 2002.

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Lockheed Martin Corp.	9,424,034	24,070,485	15,592,665
Boeing - McDonnell Douglas	32,738,149	65,981,813	12,261,227
Raytheon Company	2,304,572	3,767,230	6,120,469
Bath Iron Works Corp.	1,214,695	330,520	4,164,569
Northrop Grumman Corp.	No response		2,944,473
Ingalls Shipbuilding, Inc.	No response		2,745,694
Pratt & Whitney	74,357	0	2,022,865
TRW, Inc.	70,794	23,514,753	2,010,996
General Electric Company	5,356	77,578	1,599,304
SAIC Information Services	No response		1,540,529
United Defense, L.P.	0	0	1,203,056
Computer Sciences Corp.	84,728	1,841,404	1,173,953
Bell Helicopter Textron, Inc.	No response		1,156,910
BAE Systems Technical Services	55,142	0	967,891
Honeywell International, Inc.	1,522,194	8,394,462	908,509
Dyncorp	427,612	200,801	762,608
Newport News Shipbuilding & Drydock	6,924,277	0	741,523
Bechtel National, Inc.	179,558	158,218	735,434
Canadian Commercial Corp.	No response		659,145
Westinghouse Electric Corp.	No response		619,694
Raytheon Engineers & Construction	No response		598,725
Rockwell Collins, Inc.	0	0	593,550
Brown & Root Services	53,553	6,649	590,689
Atlantic Richfield Company, Inc.	0	0	558,129
ITT Federal Services Corp.	No response		556,422
Foundation Health Federal Services	0	0	550,668
Beneco Enterprises, Inc.	No response		499,464
Alliant Techsystems	2,620,865	528,680	462,132
Federal Express Corp.	0	0	452,513

Appendix II
List of Contractors We Surveyed and Results

(Continued From Previous Page)

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Expresser Transport Corp.	0	332,423	426,798
Stewart & Stevenson Services	No response		424,053
Booz Allen & Hamilton, Inc.	No response		421,237
Federal Ministry	No response		410,555
The Mitre Corp.	0	0	409,221
Sverdrup Technology, Inc.	0	0	395,160
Motorola, Inc. ^a	451,374	2,222,106	392,952
Interstate Electronics Corp.	No response		373,024
Oshkosh Truck Corp.	0	1,184,999	372,916
Alascom, Inc.	0	0	358,116
Massachusetts Institute of Technology	No response		347,248
Triwest Healthcare Alliance Co.	0	0	334,342
The Aerospace Corp.	0	0	334,194
AM General Corp.	0	142,216	332,383
J.A. Jones Construction Co.	No response		331,725
Electronic Data Systems Corp.	1,280	9,969,770	329,391
Mobil Oil Corp. ^b	0	0	324,772
Sencom Corp.	No response		321,788
Johns Hopkins University	11,252	5,389,410	321,317
Hughes Arabia Limited	No response		308,876
Dell Marketing, L.P.	No response		299,981
GTSI	No response		299,249
Vector Data Systems, Inc.	No response		286,019
Norfolk Shipbuilding & Drydock	1,216,004	202,782	277,618
Arinc, Incorporated	No response		272,468
Harris Corp.	123,614	0	267,232
Equilon Enterprises, LLC	0	0	265,600
Texas Instruments, Inc.	2,843	0	244,741
WTAK-3, Inc. ^c	No response		241,912
Systems & Electronics, Inc.	746,438	1,135,482	237,113
Coastal Aruba Refining Company ^c	No response		231,784
The Procter Gamble Distributing Co.	No response		228,437
CACI, Inc.- Federal	264,145	583,686	220,547
Bergen Brunswig Corp.	No response		217,183
Anthem Alliance Health Insurance ^b	0	0	215,299
Johnson Controls World Service	No response		214,447

Appendix II
List of Contractors We Surveyed and Results

(Continued From Previous Page)

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Mantech International Corp.	No response		211,471
B.F. Goodrich Aerospace	0	282,274	204,447
Parsons Corp.	No response		204,262
Bindley Western Industries	49,411	11,710,683	204,040
Rolls-Royce, PLC	No response		196,478
Foster Wheeler Environmental	203,750	1,874,331	185,755
Cubic Defense Systems, Inc.	22,421	0	184,474
Resource Consultants, Inc.	No response		182,720
Emery Air Freight Corp.	17,855	292,236	165,119
Unisys Corp.	0	0	163,238
Battelle Memorial Institute	83,894	46,296	162,749
Chugach Management Services	0	0	162,692
Great Lakes Dredge & Dock	0	0	150,300
Kraft Foods, Inc.	20,914	134,441	149,545
AAI/ACL Technologies, Inc.	0	0	149,537
Motor Oil (Hellas) Corinth	0	636,200	148,432
Metro Machine Corp.	0	0	147,301
Lucent Technologies, Inc.	No response		143,019
Hunt Building Corp.	0	1,023,459	140,314
General Atomics Aeronautical	0	0	134,234
Sierra Health Services, Inc.	0	0	134,022
EG&G Technical Services, Inc.	No response		130,811
Conoco, Inc.	No response		130,735
Humana Military Healthcare	0	0	129,163
CH2M Hill Companies, Ltd.	24,368	1,500,973	127,505
Rand Corp.	516,231	3,763	127,079
Bell Atlantic Network Services	No response		126,906
Navajo Refining Company	0	0	121,075
Spectrum Astro, Inc.	0	0	111,579
Oracle Corp.	No response		91,294
M.S. Aerospace	No response		90,220
Ameriquel Group, LLC	No response		89,682
Digital System Resources, Inc.	0	163,000	87,939
Paramount Petroleum Corp.	No response		82,708
Bay Ship Management Inc.	No response		77,957
Mantech International Corp.	No response		77,744

Appendix II
List of Contractors We Surveyed and Results

(Continued From Previous Page)

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Ocean Triumph Shipping, Inc.	0	58,156	76,347
EER Systems, Inc.	No response		73,770
Todd Pacific Shipyards Corp.	No response		72,599
Mevatec Corp.	13,712	212,212	72,147
Petro Star Valdez, Inc.	0	6,403	64,050
Sparta, Inc.	3,671	0	63,027
Earl Industries, LLC	18,115	0	62,942
RQ Construction, Inc.	0	252,161	61,114
Dynetics, Inc.	0	6,828	58,620
Sealift Holdings, Inc.	0	0	56,972
Gary-Williams Energy Corp.	0	0	56,528
Colsa Corp.	No response		56,295
Environmental Chemical Corp.	0	1,434,416	54,578
Viasat, Inc.	0	0	54,002
Premier Technology Group, Inc.	69,731	0	53,987
American Renovation & Construction	No response		53,710
Scientific Research Corp.	29,356	354,671	53,248
Storage Area Networks, Inc.	0	0	52,439
Nan, Inc.	0	1,342,934	52,342
Bender Shipbuilding & Repair	0	0	52,296
Bioport Corp.	0	0	51,550
Signal Corp.	0	0	51,266
Federal Data Corp.	No response		50,839
NLX Corp.	0	409,241	50,416
Spectral Systems, Inc.	0	0	49,761
The Wornick Company	0	53,760	49,648
Applied Research Associates	0	325,673	48,428
CAS, Inc.	0	248,645	48,398
Placid Refining Company, LLC	0	0	47,004
Sytex, Inc.	0	0	45,745
Sabreliner Corp.	No response		45,125
N.E.T. Federal, Inc.	No response		44,838
Point Blank Body Armor, Inc.	No response		43,982
Sharp, George G, Inc.	No response		43,464
DJ Manufacturing Corp.	No response		41,873
Jaycor, Inc.	No response		41,002

Appendix II
List of Contractors We Surveyed and Results

(Continued From Previous Page)

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Ages Group, LTD Partnership	200,459	733,264	40,785
Sundt/Ninteman, Joint Venture	0	0	40,721
KDI Precision Products, Inc.	0	0	40,594
Landmark Construction Corp.	0	0	39,070
Fibertek, Inc.	0	0	38,928
World Wide Technology	No response		38,423
Evans & Sutherland Corp.	0	0	38,237
Mission Research Corp.	7,878	150,957	37,891
U.S. Oil & Refining Co.	0	0	37,729
Assurance Technology Corp.	0	0	37,411
Tybrin Corp.	0	9,011	36,823
Griffin Services, Inc.	0	0	36,370
Sierratech, Inc.	0	0	35,565
Sevenson Environmental Service	0	0	35,538
O.K. James Construction, Inc.	No response		34,276
Baltimore Marine Industries	0	270,008	33,910
McBride and Associates, Inc.	No response		33,901
Logistic Services International	0	0	33,798
American Mechanical, Inc. ^c	No response		33,791
Pride Companies, LP	No response		33,355
Cormorant Shipholding Corp.	0	11,544	33,156
Dataline, Inc.	22,375	0	31,548
Golden Manufacturing, Inc.	12,293	11,880	31,391
Specialty Plastic Products	No response		31,385
Science & Engineering Associates	0	0	31,275
S.W. Day Construction Corp.	No response		31,012
Premco Holdings, Inc. ^c	No response		30,905
Space Mark, Inc.	0	89,000	29,874
Condor Systems, Inc.	0	2,250	29,830
Nichols Research Corp.	No response		29,750
Petroleum Traders Corp.	2,333	1,880	29,391
Sy Technology, Inc.	155,756	641,422	29,247
J.F. Taylor, Inc.	0	0	28,728
Soza & Company, Ltd.	0	1,650,253	28,224
DME Corp.	No response		28,066
Bulova Technologies, LLC	0	106,941	27,913

Appendix II
List of Contractors We Surveyed and Results

(Continued From Previous Page)

Contractor name	Dollars of overpayments	Dollars of underpayments	Fiscal year 2000 contract actions (dollars in thousands)
Engineering Research & Consulting	0	0	27,511
E-OIR Measurements, Inc.	0	0	27,418
Butt Construction Company, Inc.	0	0	27,166
Akima Corp.	0	0	26,904
Martin Electronics, Inc.	0	2,306	26,711
Bradley Broadcast Sales, Inc.	0	0	26,469
Manufacturing Technology, Inc.	No response		26,312
Sechan Electronics, Inc.	0	0	26,305
SMF Systems Corp.	0	0	26,280
Camber Corp.	No response		26,243
Total	61,991,268	176,088,939	

^aUnits that reported these amounts are now General Dynamics Decision Systems, Inc.

^bResponses indicated that these companies no longer have DOD contracts.

^cSurveys were returned due to invalid addresses.

Contractor Survey

REPORTING FORMAT FOR INFORMATION REQUESTED BY THE U. S. GENERAL ACCOUNTING OFFICE

The Chairman of the House Committee on Government Reform has asked the U. S. General Accounting Office (GAO) to obtain data from contractors on the extent of overpayments (any dollars owed) and underpayments (dollars owed to you) outstanding on contracts with the Department of Defense (DOD). This data will be used as part of an ongoing assignment (GAO code 192036) to update the status of DOD's contract overpayments and underpayments and to determine what progress has been made from prior reports. Please follow the attached instructions when accumulating the requested information and return it in the enclosed envelope by **October 26, 2001**. If you do not have any overpayments or underpayments, we would still appreciate you returning this survey indicating that you have not identified any such payments. Please return your completed survey and schedules by mail, fax or obtain a survey by email:

Mr. Harold D. Reich U.S. General Accounting Office Los Angeles World Trade Center 350 South Figueroa Street, Suite 1010 Los Angeles, CA 90071	Or	Fax to: Harold D. Reich (213) 830-1180	Or	Get Email format from (reichh@gao.gov)
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Any questions should be directed to Harold Reich at (213) 830-1078 (reichh@gao.gov) or Eric Johns at (213) 830-1154 (johnse@gao.gov) in our Los Angeles Field Office or Al Steiner in our Washington, D.C. office at (202) 512-9332 (steinera@gao.gov).

I. GENERAL INFORMATION

- We are requesting information on the single business unit at the address listed below, unless you find an Attachment 3 in your survey. If you have an Attachment 3 your response should be an aggregate response for all listed and confirmed business units, or any units you might add, for which you handle accounts receivable and payable.

(Please make any corrections to address in this space)

- Please provide the name and telephone number of a contact in the accounting and financial unit for us to contact if additional information is needed:

NAME OF CONTACT: _____ EMAIL ADDRESS: _____

PHONE NUMBER: (____) ____ - _____

- If your business unit is a subsidiary of a parent company, please list the name, DUNS number, and address of the parent business.

PARENT COMPANY: _____ DUNS: _____

BUSINESS ADDRESS: _____

- Does your business unit prepare contract billings and maintain accounts receivable for contracts with the DOD? [NOTE: If we have called you to make other arrangements, please proceed directly to question 5 as we already have the information for this question.]

- Yes (GO TO QUESTION 5)
- No (READ INSTRUCTION IN BOX BELOW.)

STOP – If you answered “No” to question 4 above, please do not continue but return this request in the enclosed envelope after supplying the information requested in this box.

Please do not forward to the business unit that does your billings and maintains your accounts receivable. Instead, please provide the name and address for the business unit that maintains your accounts receivables so we can verify that the unit has been included in the initial mailing of this data request.

(List below the name and address of the business unit that maintains your accounts receivable:

NAME:

ADDRESS:

CONTACT PERSON:

PHONE:

**Appendix III
Contractor Survey**

II. CONTRACT INFORMATION

5. From your accounts receivable and payable ledgers, or other appropriate accounting record, provide total gross dollar amounts of existing overpayments and underpayments (billed amounts versus payments received) for **all** DOD contracts as of **September 30, 2001** (or if September 30 is impracticable, please specify the "as of" date you have used). **Overpayments** should exclude advance payments. The total **underpayments** extracted should exclude 1) billings less than 30-days old on the "as of" date for the information provided (this excludes billings for which payments are not delinquent), and 2) claims, accounts under dispute, and unbilled receivables on long-term contracts. However, we expect overpayments or underpayments caused by incorrect liquidation of progress payments to be included in the summary totals provided in response to this question.

Gross **Overpayment** Dollar Amount: _____

Gross **Underpayment** Dollar Amount: _____

As of date used: _____
MM / DD / YYYY

6. For each **overpayment** exceeding \$1,000, please provide the following information on the Schedule for Contract Overpayments (Attachment I): contract number, the amount of the overpayment, the date the overpayment was identified; action you have taken (i.e., notified DCMA and/or DFAS, adjustments by check, offset, or no action); indicate whether you received a demand letter for the overpayment, and the potential cause for each payment.

If you are unable to provide this detail contract information, please briefly explain why it is not available:

7. For each **underpayment** exceeding \$1,000, please provide the following information on the Schedule For Contract Underpayments (Attachment II): contract number, the amount of underpayment, the date the underpayment was identified; notification and the action you have taken; and the potential cause for the underpayment.

If you are unable to provide this detail contract information, please briefly explain why it is not available:

8. List the most recent annual dollar amount of gross contract billings to DOD by this business unit.

YEAR ENDING: _____ / _____
Month / Year

GROSS DOLLAR AMOUNT
OF BILLINGS TO DOD: \$ _____

9. Please include any additional information or specific comments and issues concerning your DOD contract payment experiences that you believe we should consider.

Please retain any work sheets or records used to prepare this response.

Thank you for your prompt response.

**Appendix III
Contractor Survey**

Enclosure 2

**INSTRUCTION SHEET
FOR COMPLETING INFORMATION REQUEST**

I. GENERAL INFORMATION

The information requested regarding the business unit reporting is intended to identify the unit providing the information. Please make any appropriate changes to the name and address of your business unit (Question 1). Please provide the name, telephone number, and email address of a contact person (Q2) who could best respond to our technical questions about the information you provide. Also identify the parent company of this business unit (Q3) providing the name, DUNS number, and mailing address.

II. CONTRACT INFORMATION

Q4. The accounting and finance unit that maintains the accounts receivable and related billing accounts for contracts with DOD should respond to this data request. We intended to send this data request to the business units that are listed in the CCR and could maintain accounts receivable and billing records. If your unit does not maintain these records, please provide the name, address of the business unit and a contact with phone number who maintains your accounts receivable for DOD contracts, but do not forward this request to that unit.

Q5. From your accounts payable and receivable ledgers or other appropriate accounts that include information by individual billing numbers (invoices and vouchers), please provide the total gross dollar amounts of overpayments and underpayments (including unpaid bills) for all DOD contracts billed directly to the government as of September 30, 2001. If the information is not available as of this date, provide the information for a date as close as practicable and specify the date used. The total underpayments extracted should exclude billings less than 30-days old on the "as of" date for the information provided (this excludes billings for which payments are not delinquent). Please ensure that you do not consider (1) advance payments as overpayments and (2) claims, amounts under dispute, and unbilled receivables on long-term contracts as underpayments.

The amounts listed in response to question 5 should provide a point-in-time measurement of total underpayments and overpayments as shown by contractor records and include the effects of incorrectly liquidated progress payments. We recognize that the payment status for DOD contracts will change after the "as of" date.

Q6. Following the instructions below, please complete the Schedule for Contract Overpayments(Attachment I).

Column	Instructions
a, b, c	Enter the contract number, amount of the overpayment, and date on which the overpayment was identified. Provide this information for individual contract overpayments exceeding \$1,000. Do <u>not</u> include advance payments. Round dollar amounts to the nearest dollar.
d, e	If you have notified DOD of the overpayment, specify which DCMA and/or DFAS office you contacted and the date you notified them.
f, g, h	Check if you have made payment by check, made plans to offset against another payment, or if no action has been taken.
i, j	If a demand letter was received from DOD for the overpayment, please indicate the date of the letter and which DCMA or DFAS office sent it.
k	For the potential cause, please provide a brief description—i.e., contract modification-scope change, contract modification-price adjustment, contract modification-other, duplicate payment, recording error, etc.

Q7. Following the instructions below, please complete the Schedule for Contract Underpayments(Attachment II).

Column	Instructions
a, b, c	Enter the information indicated for individual contract underpayments exceeding \$1,000. Round dollar amounts to the nearest dollar.
d, e, f	If you have notified DOD of the underpayments, specify which DCMA and/or DFAS office you contacted and the date you notified them. Or if no action taken, check column f.
g	For the potential cause, please provide a brief description—i.e., progress payment calculation error, prices not updated, recording error, lost inventories, contract modification not processed, etc.

Q8. State the volume of business your business unit has with DOD as measured by total gross billings to DOD for your most recent year ending date. Please include the ending date (month and year) for the total billings listed.

**Appendix III
Contractor Survey**

Attachment 3

Business Units Handle By Your Accounts Receivable and Payable Office

INSTRUCTIONS: Through review of the Central Contract Registry (CCR), or by prior contact with your company, we have indications that your business unit maintains the accounts receivable and payable for each of the units listed below. Please confirm that you do maintain accounts for each of these business units by 1) crossing out any units not maintained, and 2) adding the name and address of any additional units for which you maintain these accounts. Your survey response should be an aggregate response for all the confirmed business units.

ADDITIONAL SITES:

**Appendix III
Contractor Survey**

Attachment I

Schedule for Contract Overpayments (Exceeding \$1,000)
(See Enclosure 2 for detail instructions on completing this schedule.)

IMPORTANT: Please ensure that you do not consider advance payments as overpayments.

a Contract Number	b OVERPAYMENT (Insert information.)		c ACTION TAKEN OR PLANNED				d DEMAND LETTER (Only if letter received.)		k CAUSE FOR OVERPAYMENT (Describe briefly.)	
	Amount of Overpayment (Round to the nearest dollar)	Date Overpayment Identified & By Whom (Contractor or DOD)	Notifying DOD (Insert information.) DFAS or DCMA Office Notified	Return Overpayment by Check	Adjustments (Check one column.) f Return Overpayment by Check	g Offset Against Another Payment	h No Action Taken	i Date of Demand Letter		j DOD Office Sending Demand Letter
1.				Done	Planned	Done	Planned			
2.										
3.										
4.										
5.										
6.										
7.										
8.										
9.										

**Appendix III
Contractor Survey**

Attachment 2

Schedule For Contract Underpayments (Exceeding \$1,000)
(See Enclosure 2 for detail instructions on completing this schedule.)

IMPORTANT: The total underpayments extracted should exclude billings less than 30-days old on the "as of" date for the information provided (this excludes billings for which payments are not delinquent). Also, do not consider claims, amounts under dispute, and unbilled receivables on long-term contracts as underpayments.

Contract Number	UNDERPAYMENT <i>(Insert Information)</i>		NOTIFICATION <i>(Insert information, or check No Action Taken)</i>			CAUSE FOR UNDERPAYMENT
	b Amount of Underpayment <i>(Round to the nearest dollar)</i>	c Date Underpayment Identified & By Whom <i>(Contractor or DOD)</i>	d DFAS or DCMA Office Notified	e Date Office Notified	f No Action Taken	
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						

Summary of Results from DCAA Visits to 28 Contractor Locations

DCAA auditors found that 17 contractor locations did not have any differences or the differences were immaterial based on their review of contractors' records and comparison to their survey responses. Shown below are 10 contractor locations with material differences identified by DCAA and the primary reasons for the differences. In addition, DCAA auditors visited 1 contractor—SAIC—that did not respond to the survey, and they found \$259,194 of overpayments and \$2,002,243 of underpayments in the contractor's records.

Contractors—material differences from survey	Overpayment differences	Primary reasons for differences	Underpayment differences	Primary reasons for differences
Ages Group ^a	(\$319,025)	Overbilled costs were not reported	0	Not applicable
Boeing – St. Louis	1,895	Not identified	(\$997,141)	Unpaid invoices not reported
Honeywell Shared Services	(6,946,813)	Unanalyzed overpayments were not reported	(7,672,885)	Unanalyzed underpayments were not reported; unpaid invoices not reported
Lockheed Martin Shared Service	(30,432,643)	Unanalyzed overpayments were not reported; outstanding payment variances and contract administration adjustments not reported	(16,554,214)	Unanalyzed underpayments were not reported
Lockheed Martin NE & SS	(37,833)	Not identified	(876,695)	Unpaid invoices not reported—only reported invoices with partial payments
Newport News Shipbuilding	(12,688,525)	Contractor failed to report overpayments; inappropriate accounting for labor and material transfers	(83,694)	Not identified
Raytheon – El Segundo	(4,028,327)	Overpayments over 1 year old were not reported	(22,612,605)	Underpayments over 1 year old were not reported; unpaid invoices not reported—only reported invoices with partial payments
TRW Space & Electronics	(75,103)	Not identified	(631,577)	Underpayments on certain contracts were not reported
TRW Systems East	0	Not applicable	1,574,295	Erroneously reported unpaid invoices under 30 days
TRW Systems West	(2,666,281)	Overpayments on certain contracts were not reported; overpayments and underpayments netted for reporting	(10,386,620)	Underpayments on certain contracts were not reported
Totals	(\$57,185,791)		(\$58,040,558)	

^aThe contractor is now Volvo Aero Services and no longer has DOD contracts.

Comments from the Department of Defense



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

MAY 23 2002

Mr. Gregory Kutz
Director Financial Management and Assurance
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Kutz:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report GAO-02-635, "DoD CONTRACT MANAGEMENT: Overpayments Continue and Management and Accounting Issues Remain," dated April 19, 2002.


As indicated in your draft report, the Department has taken positive steps to address contract overpayments. The DFAS consolidated the management of contract and vendor pay operations and we have improved payment process controls and employed data mining to identify erroneous payments for recovery. New payment system edits have reduced duplicate payments from 94 in the first 6 months of fiscal year (FY) 2001 to 23 in the first 6 months of FY 2002 and we have improved system controls over progress payment liquidation rates.

The accounts receivable module in the Mechanization of Contract Administration System is being modified to improve timeliness in collecting amounts due, and the DFAS revised its debt management procedures, with over 2,000 cases transferred to the Department of the Treasury for collection since May 2001. In addition, my office is developing performance indicators for senior DoD management that target accounts receivable, overpayments, and aging.

Defense Contract Audit Agency resources are in use to detect overpayments and promote improved contractor policies and billing system internal controls. As you noted, DCAA audits have identified over \$50 million in overpayments, most of which were promptly resolved.

Responses to the draft report recommendations and other technical comments are in the enclosure. The Department appreciates the opportunity to comment on this draft report. My staff point of contact on this matter is Mr. Chuck Crichley. He may be reached by e-mail: crichlec@osd.pentagon.mil or by telephone at (703) 602-0369.

Sincerely,


Dov S. Zakheim

Enclosure

OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)

Draft Audit Report, "CONTRACT MANAGEMENT: Overpayments Continue and Management and Accounting Issues Remain" (GAO Code 192036)

* * * * *

COMMENTS ON THE RECOMMENDATIONS

RECOMMENDATION: Implement an internal control, as required by 31 U.S.C. 3561, to identify and collect overpayments to contractors, regardless of contract payment type.

DoD RESPONSE: Concur. The Department of Defense endorses the requirement for a program to identify errors made in paying contractors and recover any amounts paid to those contractors. In fact, the Department was taking a number of actions to implement such a program even before the enactment of 31 U.S.C. 3561. In addition to the conduct of pilot recovery audit programs using private contractors, the Department is using internal resources to detect overpayments, determine systemic causes, and take appropriate corrective actions. These actions are reducing the number of erroneous payments and hastening collections.

The Defense Finance and Accounting Service (DFAS) has improved its entitlement and payment process controls to isolate potential improper payments and successfully is using data mining to identify erroneous payments for recovery. This work has resulted in the implementation of new payment system edits to minimize future erroneous payments. Automated internal control processes to identify potential duplicate payments recently were added to the Mechanization of Contract Administration System (MOCAS). As a result, duplicate payments detected were reduced from 94 in the first 6 months of fiscal year 2001 to 20 in the first 6 months of fiscal year 2002. Two additional changes that help eliminate duplicate payments now are in process. First, a new system query has been developed to ensure that progress payment liquidation rates in two MOCAS modules are consistent. The new procedure will help reduce progress payment liquidation differences that the General Accounting Office reported were the primary cause of over and underpayments. A second system query is being used to identify contracts that require special payment instructions. New contracts are being screened as received. Deficiency notices are being sent to contracting officers to ensure corrective action. In the vendor pay network, new software is being used to detect and prevent duplicate payments. In the area of debt collection, the DFAS instituted new debt management procedures and transferred over 2,000 cases to the Department of the Treasury for collection.

Further, the Department is making better use of its contract audit resources to detect overpayments and promote improved contractor policies and billing system internal controls. The Defense Contract Audit Agency (DCAA) has modified its practices to test the effectiveness of contractors' billing system internal controls in the areas of overpayments and refunds to the government.

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Upon issuance, the Department will comply with Office of Management and Budget guidance on the conduct of a cost-effective program to identify errors made in paying contractors.

RECOMMENDATION: Reevaluate DCMA, DoD Comptroller, and DFAS established procedures and controls and revise them as needed to ensure prompt recognition and recording of receivables and potential liabilities stemming from DoD's contract management and payment processes, according to federal accounting standards and financial management system requirements.

DoD RESPONSE: Concur. The Department's financial management guidance on recording accounts receivable, accounts payable, and account aging is consistent with the federal accounting standards. The issue is compliance with established policy. In deciding what steps may be necessary to improve compliance, it is necessary to consider the processes in place, factors that establish claims or obligations, and the need to manage in efficient and cost-effective ways. For example, contractor billing rate adjustments do not result in contract modifications and normally are resolved within the normal billing cycle; the Federal Acquisition Regulation "Allowable Cost and Payment" clause allows contractors up to 120 days after the settlement of indirect cost rates to submit a completion voucher; and refunds from contractors include routine amounts of penalties and interest, government property rental payments and sales proceeds. The recording of receivables and payables becomes an issue when such transactions are not resolved timely and aged, as indicated in the draft report.

The DFAS revised its debt management procedures and is transferring more debts for collection. Over 2,000 cases have been transferred to the Department of the Treasury for collection since May 2001. The DFAS is further reviewing and revising its procedures in this area. A manual payment procedure implemented in October 2000 is preventing future duplicate payments like the January 2000 duplicate payment made to Northrup Grumman. In April 2002, a new procedure was implemented to expedite the transfer of overdue receivables to the Debt Management Office for collection. Finally, in January 2002, new procedures were issued that address recording, reporting and reconciling receivables from the public.

This office is developing new performance indicators for accounts receivable, overpayments, and aging. These measures will assure better management visibility of performance and help identify any further actions needed.

RECOMMENDATION: Develop and maintain more comprehensive and complete records on contractor refunds and underpayments to better measure and monitor: (1) the timeliness of all collections, including checks and offsets, (2) the resolution of demand letter disputes, (3) the causes of overpayments and underpayments, (4) the resolution of over and underpayments and the need for corrective actions, and (5) compliance with policies and procedures.

DoD RESPONSE: Concur. The MOCAS accounts receivable module currently lacks the ability to capture the accrual date of a debt, but that module will be modified to measure timeliness in the collection of amounts due. Underpayments, when validated, are paid immediately. The DFAS monitors the number of disputes and is working to reduce the backlog and keep it small. Contractor cooperation and Defense Contract Audit Agency assistance are contributing to the reductions. The DFAS Contract Pay Operations, Customer Service, and Contract Reconciliation functions detect over and underpayments. Root cause statistics are collected and recorded for two of the three functions. The DFAS Columbus site (DFAS-CO) will study the feasibility of using error codes in Contract Pay Operations and make a decision by September 30, 2002. Full compliance with all procedures is expected, and procedures are reviewed and updated continuously.

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TECHNICAL COMMENTS

Page 3, Middle Paragraph, et al. The second sentence comments that the DCAA audits large contractors, to identify overpayments and ensure that contractors have adequate internal controls for prompt identification and reporting of overpayments. The report suggests that DCAA efforts may be considered part of a recovery audit program. This is a mischaracterization of the DCAA role as the Department's contract auditing organization. The distinction between contract auditors and those who perform recovery "audits" should not be confused. The purpose of contract auditing is to assist in achieving prudent contracting by providing procurement officials with financial information and advice relating to the effectiveness, efficiency, and economy of contractors' operations. In doing so, the DCAA reviews contractor records. Recovery auditing is the practice of identifying and recovering overpayments. In recovery auditing, the review is normally limited to an examination of government financial and procurement records.

Page 7, Final Sentence. The sentence states that for the remaining 71 percent of the overpayments, contractors did not indicate any planned action. The following should be added as the final sentence:

"The DCAA plans to follow up on the overpayments to ensure that all are properly handled."

Page 9, Bottom Paragraph. The third sentence states that the DCAA did not recover overpayments on a contract because the underpayments exceeded them. The sentence is not technically correct, and is not complete in its explanation. The wording should be changed to read as follows:

"DCAA officials stated that the contract was in a net underpaid status and the contractor has basic internal controls for overpayments. After consulting with the DFAS, it was decided that settlement of the final contract amount and any resulting overpayment or underpayment would be deferred until the DFAS contract reconciliation is completed. The

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DCAA is assisting the DFAS' reconciliation of the contract through the DCAA project on audits of contractor prepared reconciliations."

Page 16, Final Sentence. The sentence states that the DCAA is working with the DFAS-CO on reconciling contracts. The sentence should be changed to indicate that the DCAA is performing audits of contractor prepared reconciliations, and that the DFAS uses the results in completing the contract closeout process.

Page 19, Middle Paragraph. The second and third sentences state that the DCAA's preliminary conclusion is that demands for return of contract overpayments that it reviewed, which had not been resolved for over a year, may not be valid. The DCAA is still in the process of examining contractor data and has not reached a conclusion on the possible overstatement of accounts receivable. The sentences should be revised to indicate that it is too soon to state whether the debts are valid or DFAS-CO accounts receivable are overstated.

Page 24, Second Paragraph. The fifth sentence notes that the Defense Contract Management Agency and the DFAS do not always issue demand letters for contract debt based on contract administration because the debt could be resolved promptly and issuing a demand letter would involve additional effort. Some contract administration actions do not result in modifications, such as auditor or contracting officer billing rate adjustments made by mutual agreement (FAR 42.704). In this and other instances, such as the settlement of final indirect cost rates or noncompliance with Cost Accounting Standards, the appropriate and expeditious method of resolution is routine offset, as provided for in FAR 32.611. The DFAS believes that its current practice of using offsets is in full compliance with the procurement regulation.

Page 25, Middle Paragraph

1. The draft report correctly observes that there is no requirement for notification of overpayment arising from contract administration actions. This is because an amount owed by the contractor as a result of a contract administration action does not arise from an invoice payment by the government, and thus is not subject to the provisions (including the overpayment notification provision) of the prompt payment clause. If a contract administration action consists of a change to contract requirements (e.g., delivery schedule or quantities) the modification that revises contract requirements also will indicate whether an equitable adjustment is due the contractor or the government. If the government is due an equitable adjustment, a demand letter should be issued in conjunction with the contract modification. Because of the normal sequence of events, no purpose would be served by requiring a contractor to provide notification of overpayment. Other contract administration actions can result in either the contractor owing the government money, or vice versa, and arise from the normal and expected operation of the contract's provisions, e.g., adjustment of the contract's provisional billing rates. Typically, any amount owed either by the contractor or by the government as the result of a change to billing rates, or similar contract administration action, is resolved as part of the billing and payments process provided for under the contract (i.e., when the contractor makes, and the government pays, the contractor's next payment request). Consequently, the contractor's submittal of timely, accurate payment requests in accordance with the terms of the contract, in effect subsumes any amount due the government which may have arisen as a result of contract administration. In

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these instances, a separate requirement for notification of overpayment arising from contract administration actions would be redundant and potentially confusing.

2. The third sentence states that the overpayment notification requirement (in the clauses for prompt payment) is binding only if the contracting officer includes the clause in the contract. This sentence gives the impression that contracting officers have the latitude to leave the applicable prompt payment clause out of contracts. FAR 32.908 requires the inclusion of the appropriate prompt payment clause in contracts, except when the clause at 52.212-4, "Contract Terms and Conditions-Commercial Items," applies, or when other governmental authority (e.g., tariffs) establishes payment terms and late payment penalties. FAR Case 2001-005 will add the requirement for notification of overpayments to FAR 52.212-4.

3. The fourth sentence states that the Department's efforts to reduce progress payment liquidation problems have not been fully effective. It goes on to say that contracting officers have not always provided payment instructions in accordance with policy and the DFAS had not always followed payment instructions when provided, thereby creating the likelihood of future payment problems. This comment appears to be misplaced since a lack of payment instructions leads to the question of whether the correct appropriation is being charged when a payment is made, not whether a contract will be over or under paid.

4. The seventh sentence states that the prompt payment clause should be expanded to include financing payments so that all contractor debt will be promptly identified, reported and collected. Because the Prompt Payment Act does not apply to financing payments, other than interim payments of services contracts, the Department has chosen not to revise the prompt payment clauses to add a reference to notification of overpayments that may occur on a financing payment. Rather, the Department has proposed that the contract financing clauses (i.e., Federal Acquisition Regulation (FAR) 52-216-7; 52.216-13; 52.232-7; 52.232-16; 52.232-30; 52.232-32; and 52.232-39) be revised to add the same notification of overpayment requirement as was recently added to the prompt payment clauses. This revision to financing clauses is being accomplished via FAR Case 2001-005; that case has been approved by the Defense Acquisition Regulations Council and Civilian Agency Acquisition Council, and currently is awaiting approval by the Office of Federal Procurement Policy (OFPP), which must occur prior to publication as a proposed rule. FAR Case 2001-005 also modifies FAR 12.210 and the clause at FAR 52.212-4 to provide for notification of overpayments on contract financing and invoice payments on commercial contracts.

5. The paragraph concludes that the OFPP is considering adding financing payments to the prompt payment clauses. This comment is not technically correct. The FAR case (i.e., 2001-005), currently undergoing the normal OFPP review that precedes publication of a proposed rule, does not revise the prompt payment clauses. Rather, it revises the contract financing clauses to add a requirement for contractors to notify the government if they become aware of an overpayment arising from a financing payment.

Page 29, Middle Paragraph. The sentence states that DCAA preliminary results indicate that amounts due the government are not promptly returned and controls over "agreed to" offsets are

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weak. The DCAA concluded that contractor controls over offsets are weak, and that contractors used offsets. The wording should be changed to read:

“According to the DCAA, preliminary results of its contract audits indicate that (1) not all amounts due the government are returned promptly, and (2) contractor controls over offsets are weak because they lack supporting documentation and the DFAS is not always notified of offsets that occur.”

Page 30, Middle Paragraph. The first sentence states that survey results, DCAA audits and DFAS-CO data indicate that contractor debt caused by contract administration actions as well as payment problems have continued. The wording implies that contract administration debt is a problem, but that view is not one that is shared. The first sentence should be changed to read:

“Survey results, DCAA audits, and DFAS-CO data indicated that payment problems have continued with DoD contract payments--contract pay as well as vendor pay--and that resolution of payment discrepancies and contract administration actions has not always been timely.”

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